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Contingency liability under policies with mutual insurance companies; Statements on auditing procedure, No. 07

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Contingent Liability under Policies with Mutual Insurance Companies

A QUESTION has been directed to the committee on auditing procedure as to whether it is customary or necessary for a company which carries insurance with mutual insurance companies to indicate on its balance-sheet under the heading of contingent liabilities or otherwise that the company is subject to assessment under the insurance policies.

In an endeavor to ascertain the nature and extent of the contingency and the frequency with which losses have been sustained in the past, inquiries have been made of American Mutual Alliance, an association of mutual insurance groups whose members operate in the fire- and casualty-insurance field.

Information from this source indicates that, except for farm companies which usually operate in a strictly limited territory and on an assessment basis after losses are determined, companies with which the independent public accountant seldom comes into contact, there are very few mutual insurance companies in the general field which carry an unlimited-assessment provision in their policies. It is also stated that the vast majority of mutual fire and casualty companies which operate on a state-wide or national basis issue either policies under which there is no liability for assessment, commonly referred to as nonassessable policies, or limited-liability policies under which provision for an assessment of one additional premium is made. A few of these companies issue policies carrying unlimited liability. A greater number of others limit the assessment liability to from two to five times the annual premium or deposit. Occasionally the liability is limited to a small percentage of the face amount of insurance carried.

American Mutual Alliance has furnished a tabulation of special assessments levied by mutual insurance companies operating in the field referred to above which were still active at the close of 1940. This tabulation shows that only ten companies in the general class have levied assessments since 1900, and the highest of these assessments appears to have been equal to one year's premium.

The committee took into consideration the fact that deposits are required to be made by the insured which are usually several times greater than a normal year's premium, so that several years' normal losses are covered by the deposit and the likelihood of the insured being called on to pay out any amount of cash is therefore remote. As a rule, any material increase or decrease in losses is reflected by higher or lower premiums (or by lower or higher "dividends") in subsequent periods.

The committee accordingly reached the conclusion that the likelihood of any losses occurring which would wipe out the insurance deposit, or impair it by an amount which would be material in reference to the position of the insured, was so remote that there was no necessity for making a notation of such a contingency on the balance-sheet.

The committee was also of the opinion that it had not been general practice to make such notations, although the committee recognized that there had been occasional cases where, in what was probably a desire for the fullest disclosure possible, a notation had been inserted.

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